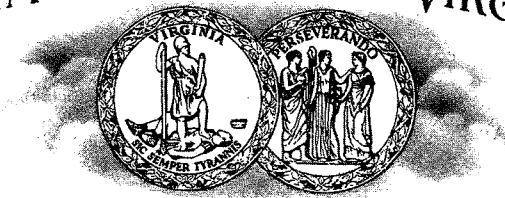


**EXAMINATION REPORT**  
**of**  
**COMMONWEALTH MUTUAL**  
**FIRE INSURANCE COMPANY**  
**St. Louis, Missouri**  
**as of**  
**December 31, 2007**

**COMMONWEALTH OF VIRGINIA**  
**STATE CORPORATION COMMISSION**  
**BUREAU OF INSURANCE**

ALFRED W. GROSS  
COMMISSIONER OF INSURANCE  
STATE CORPORATION COMMISSION  
BUREAU OF INSURANCE

# COMMONWEALTH OF VIRGINIA



P.O. BOX 1157  
RICHMOND, VIRGINIA 23218  
TELEPHONE: (804) 371-9741  
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<http://www.scc.virginia.gov/division/boi>

I, Alfred W. Gross, Commissioner of Insurance of the Commonwealth of Virginia, do hereby certify that the annexed copy of the Examination Report of Commonwealth Mutual Fire Insurance Company as of December 31, 2007, is a true copy of the original report on file with this Bureau.

IN WITNESS WHEREOF, I have hereunto set my hand  
and affixed to the original the seal of the Bureau at the City  
of Richmond, Virginia this 2<sup>nd</sup> day of July, 2008

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Alfred W. Gross  
Commissioner of Insurance

(SEAL)

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Richmond, Virginia  
March 20, 2008

Honorable Alfred W. Gross  
Commissioner of Insurance  
Commonwealth of Virginia  
Richmond, Virginia

Dear Sir:

Pursuant to your instructions and by the authority of the provisions of § 38.2-1317 of the Code of Virginia, an examination of the affairs and financial condition of

**COMMONWEALTH MUTUAL FIRE INSURANCE COMPANY**

Richmond, Virginia

hereinafter referred to as the Company has been completed. The report thereon is submitted for your consideration.

**DESCRIPTION**

The Company is a mutual assessment property and casualty insurer licensed pursuant to Chapter 25 of Title 38.2 of the Code of Virginia. The last examination was made by representatives from the State Corporation Commission's Bureau of Insurance (Bureau) as of December 31, 2004. This examination covers the period from the last examination through December 31, 2007.

**HISTORY**

The Company was incorporated under the laws of Virginia on December 29, 1953, and was licensed by the State Corporation Commission on September 30, 1957. The Company has been in operation since that date selling fire and extended coverage. In October 1989 the Company began offering burglary coverage. The Company's Certificate of Incorporation states its purpose as follows:

. . . to establish, conduct, and engage in the business of a mutual assessment fire insurance company, pursuant to and to the extent permitted under Chapter 15 of Title 38.1 of the Code of Virginia of 1950, as amended; and to do all the acts

COMMONWEALTH OF VIRGINIA  
STATE CORPORATION COMMISSION  
BUREAU OF INSURANCE

and things therein permitted to be done and performed by a mutual assessment fire insurance company, subject to the limitations and prohibitions therein contained.

### MANAGEMENT AND CONTROL

The business and affairs of the Company are managed by a board of five directors who must be members of the Company. Each director elected shall serve a term of five years and each serves until his successor is elected and qualified. The annual meeting of members is held on the third Thursday in February of each year at which time the directors are elected. At all meetings of the members, each member shall be entitled to one vote in person or by proxy. In accordance with the application for insurance, in the member's absence, the president of the Company will serve as proxy.

Officers of the Company are elected each year at the annual meeting of the Board of Directors for a term of one year. According to the bylaws, the Board of Directors' meeting is held immediately following the annual meeting of members. The president has general supervision over the officers and employees of the Company but shall be responsible to the Board of Directors. Effective control of the Company is exercised by officers and employees of United Insurance Company of America (United) through a service agreement covering all of the Company's business.

The Company's directors and officers were as follows at December 31, 2007:

#### Directors:

<u>Representative</u>	<u>Principal Occupation</u>
Donald L. Bonner	Field Trainer United Insurance Company of America Tidewater, Virginia
James J. Collins	President Commonwealth Mutual Fire Insurance Company St. Louis, Missouri
Daniel G. Denton	District Manager United Insurance Company of America Richmond, Virginia

Burns S. Hale	Assistant to the Regional Vice President United Insurance Company of America Richmond, Virginia
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Don M. Royster	President Career Agency Companies St. Louis, Missouri
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Officers:

James J. Collins	President
John R. Camillo	Secretary
Thomas D. Myers	Treasurer
David F. Bengston	Vice President
Daniel G. Denton	Vice President
Eric J. Draut	Vice President
Samuel L. Fitzpatrick	Vice President
Scott Renwick	Vice President

All of the above listed officers and directors are employees of United or one of its affiliates.

**SERVICE AGREEMENT**

Effective January 1, 2006, the Company renewed its service agreement with United. The term of this agreement is for an additional three years and may be extended by mutual agreement of the parties. Pursuant to this agreement, United manages and controls its agency force in the selling and servicing of the Company's fire insurance policies and provides administrative services pertaining to these policies. Neither United nor its authorized agents shall have the authority to accept or reject risk on behalf of the Company. All such underwriting authority is expressly reserved to the Company.

As compensation for the performance of services, the Company shall pay United a monthly fee based on the administrative costs of United, which is determined as follows:

- a. Commissions, taxes, licenses, fees and other direct expenses will be charged to the Company and United, respectively, as direct expenses.
- b. The net general insurance overhead expenses will be allocated as mutually agreed upon based on appropriate expense allocation studies which will be reviewed from time to time.

The Company paid United \$234,344, \$317,745 and \$342,264 pursuant to this agreement for the years ended 2005, 2006 and 2007, respectively.

### **FIDELITY BOND AND OTHER INSURANCE**

The Company had fidelity insurance in force at December 31, 2007, in the amount of \$25,000,000 with a \$500,000 deductible through an endorsement on Unitrin, Inc.'s financial institution bond. Unitrin, Inc. is the parent of United. The Company also has other coverages usual and customary to the nature of its business.

### **TERRITORY AND PLAN OF OPERATION**

The Company transacts its business throughout the Commonwealth of Virginia through United agents who produce and service the business. Monthly policies covering household goods and personal effects are issued in amounts up to \$20,000 insuring against fire, lightning, windstorm and several other miscellaneous property perils. The Company also issues burglary coverage up to a maximum of \$10,000. Employees of United handle all policy transactions including hiring of agents, soliciting, collecting premiums, processing claims and record keeping.

Risks are classified according to territory, availability of fire protection and types of structure in which the property is located, and rates vary accordingly.

### GROWTH OF THE COMPANY

The following data, obtained from the Company's Annual Statements and examination reports, indicates the growth of the Company for the ten-year period ending December 31, 2007:

<u>Year</u>	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Surplus</u>
1998	\$1,108,192	\$163,521	\$944,671
1999	1,170,871	165,033	1,005,838
2000	1,222,345	181,431	1,040,914
2001	1,249,793	183,149	1,066,644
2002	1,266,473	198,948	1,067,525
2003	1,319,279	210,047	1,109,232
2004	1,352,704	182,568	1,170,136
2005	1,380,350	169,773	1,210,577
2006	1,426,861	164,156	1,262,705
2007	1,487,366	169,843	1,317,523

<u>Year</u>	<u>Gross Assessments</u>	<u>Investment Income</u>	<u>Direct Losses Paid</u>	<u>Number of Policies</u>
1998	\$1,530,211	\$62,193	\$295,320	12,602
1999	1,560,933	59,978	285,422	12,599
2000	1,577,382	83,178	273,194	13,231
2001	1,708,153	49,524	327,002	13,514
2002	1,817,711	28,677	336,012	14,159
2003	1,805,221	11,232	320,682	12,715
2004	1,718,276	15,253	357,248	12,496
2005	1,670,131	29,989	294,992	11,637
2006	1,505,072	46,275	240,234	10,694
2007	1,422,735	42,181	218,018	9,906



## REINSURANCE

The Company has a quota-share reinsurance agreement with United Casualty Insurance Company of America (United Casualty), an Illinois Corporation. United Casualty was formerly Fire Insurance Company of Quaker City. This agreement provides for reinsurance of 100% of the total block of fire insurance policies sold by the Company.

According to the reinsurance agreement, the Company remits 100% of the gross premiums collected after deducting from premiums the following items:

- Premium taxes
- Return premiums
- Agents' compensation
- Field-management compensation
- Losses paid
- Loss adjustment expense paid
- Agents' license fees
- Service fees and cost reimbursement paid to United
- Direct costs incurred by the Company relating solely to the  
business quota-share reinsured hereunder as may be  
mutually agreed upon

The reinsurance agreement further states that in the event the above described deductions for any monthly accounting period shall exceed the gross premiums collected for such period, United Casualty shall reimburse the Company 100% of the amount by which deductions exceed gross premiums collected for the period.

In addition to the amounts withheld above, United Casualty pays to the Company a reinsurance commission of 1% of the collected premiums on all of its fire insurance policies.

This reinsurance agreement contains an insolvency clause.

## **SCOPE**

This is a full scope financial condition examination initiated and conducted under the provisions of Article 4, Chapter 13 of Title 38.2 of the Code of Virginia. The examination covers the period from January 1, 2005 through December 31, 2007. Assets were verified and liabilities were established at December 31, 2007. A review of income and disbursements for the period was made to the extent deemed necessary.

The items comprising the Balance Sheet had medium or low risk assessment as determined from the *National Association of Insurance Commissioners Examiners Handbook*. Analytical review procedures were applied to non-material items.

In addition, the following items were reviewed, several of which are discussed separately under their respective captions in this report:

- History
- Management and Control
- Fidelity Bond and Other Insurance
- Territory and Plan of Operation
- Conflict of Interest
- Growth of the Company
- Reinsurance
- Accounts and Records
- Financial Statements

## **FINANCIAL STATEMENTS**

There follows a statement of income and disbursements for the period under review and a statement of financial condition as of December 31, 2007.

**INCOME FOR THE PERIOD UNDER REVIEW**

	<u>2005</u>	<u>2006</u>	<u>2007</u>
Interest on bonds	\$21,294	\$41,547	\$37,560
Interest on cash deposits	1,424	1,309	618
Interest on short-term investments	7,271	3,419	4,003
Other income:			
Quota share reimbursement	<u>270,355</u>	<u>348,272</u>	<u>356,416</u>
Total Income	\$300,344	\$394,547	\$398,597
Deduct total disbursements for the year	<u>271,652</u>	<u>341,222</u>	<u>361,599</u>
Net Income	\$28,692	\$53,325	\$36,998
Add Ledger Assets December 31, previous year	<u>1,337,508</u>	<u>1,366,200</u>	<u>1,419,525</u>
Ledger Assets December 31, current year	<u><u>\$1,366,200</u></u>	<u><u>\$1,419,525</u></u>	<u><u>\$1,456,523</u></u>

**DISBURSEMENTS FOR THE PERIOD UNDER REVIEW**

	<u>2005</u>	<u>2006</u>	<u>2007</u>
Commissions and brokerage	(\$16,423)	(\$15,051)	(\$14,227)
Directors' fees	400	500	500
Boards, bureaus and associations	1,217		
Legal and auditing			1,100
Service fees	234,344	317,745	342,264
Other expenses	12,620		
Taxes, licenses and fees:			
VA premium license tax	34,394	30,028	27,657
Assessment for maintenance of			
Bureau of Insurance			452
Flood prevention & fraud prevention			853
Federal corporate income tax	<u>5,100</u>	<u>8,000</u>	<u>3,000</u>
Total disbursements	<u><u>\$271,652</u></u>	<u><u>\$341,222</u></u>	<u><u>\$361,599</u></u>

**ASSETS**

	<u>Ledger Assets</u>	<u>Non- Ledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>
Bonds	\$1,158,680			\$1,158,680
Cash on deposit	263,321			263,321
Short-term investments	33,419			33,419
Interest due and accrued on bonds		18,431		18,431
Accounts receivable	1,103	12,412		13,515
Totals	<u>\$1,456,523</u>	<u>\$30,843</u>	<u>\$0</u>	<u>\$1,487,366</u>

**LIABILITIES, SURPLUS AND OTHER FUNDS**

Funds held by company under reinsurance treaty	\$150,000
Taxes, licenses and fees:	
VA premium license tax	12,412
Federal corporate income tax	431
Accounts payable	<u>7,000</u>
Total liabilities	\$169,843
Excess of admitted assets over liabilities (surplus)	<u>1,317,523</u>
Totals	<u>\$1,487,366</u>

## **RECOMMENDATIONS FOR CORRECTIVE ACTION**

### **Management and Control**

1. Code of Virginia § 38.2-2509 requires that the management of any mutual assessment property and casualty insurer be vested in a board of at least five directors, each of whom shall be a member of the insurer. The Examiners noted that a director's policy lapsed in August 2007 and the policy was not reinstated prior to the director retiring in February 2008. Once the policy lapsed, the director was no longer a member and therefore the Company was not in compliance with Code of Virginia § 38.2-2509. The Examiners recommend the Company comply with the Code of Virginia.

### **Accounts and Records**

2. Code of Virginia § 38.2-1318 B states, in part, "...in conducting the examination, the examiner shall observe, to the extent practicable, those guidelines and procedures set forth in the Examiners' Handbook..." In order to verify the existence of securities, the NAIC Examiners' Handbook requires that the securities be (i) maintained in a manner that will allow the examiner to perform an actual inspection or count or (ii) held pursuant to a custodial or safekeeping agreement with a bank, trust company, or securities depository. The Company had an executed custodial agreement; however, it did not contain all of the required controls.

The Examiners recommend the Company ensure that the custodial or safekeeping agreement have the controls outlined in the NAIC Examiners' Handbook. This is the second consecutive examination in which this recommendation appears.

**SUBSEQUENT EVENTS**

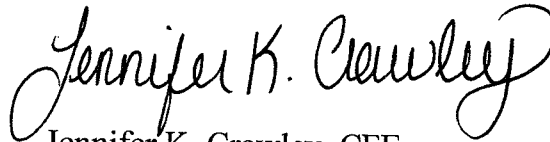
Burns S. Hale retired as a director effective at the annual meeting on February 21, 2008. At this meeting, the Board of Directors elected Deborah L. Quaglia to succeed Mr. Hale as director.

**CONCLUSION**

The courteous cooperation extended by the Company's officers and employees during the examination is gratefully acknowledged.

In addition to the undersigned, Mario A. Cuellar, CFE of the Bureau participated in the work of the examination.

Respectfully submitted,

A handwritten signature in black ink, reading "Jennifer K. Crawley". The signature is written in a cursive, flowing style with a large initial "J" and a long, sweeping underline.

Jennifer K. Crawley, CFE  
Insurance Examiner



COMMONWEALTH MUTUAL  
FIRE INSURANCE COMPANY

08 JUN 23 AM 9:19

June 17, 2008

Commonwealth of Virginia  
State Corporation Commission  
Bureau of Insurance  
Mr. David H. Smith, CFE, CPA, CPCU  
1300 East Main Street  
Richmond, Virginia 23219

Attention: David H. Smith  
Chief Examiner

Re: Commonwealth Mutual Fire Insurance Company  
Examination Report as of December 31, 2007

Commonwealth Mutual Fire Insurance Company ("the Company") does not take issue with any matter contained in the above reference examination report.

The examination report included two recommendations for corrective action. Noted below are procedures that have been implemented or anticipated to be implemented with respect to each recommendation for corrective action.

Management and Control

Code of Virginia § 38.2-2509 requires that the management of any mutual assessment property and casualty insurer be vested in a board of at least five directors, each of whom shall be a member of the insurer. The Examiners noted that a director's policy lapsed in August 2007 and the policy was not reinstated prior to the director retiring in February 2008. Once the policy lapsed, the director was no longer a member and therefore the Company was not in compliance with Code of Virginia § 38.2-2509. The Examiners recommend the Company comply with the Code of Virginia.

Response

The director whose policy lapsed is no longer employed by the Company's affiliate, United Insurance Company of America, and has resigned his position as director with the Company. The newly elected director is a member of the insurer and the Company is now in compliance with the Code of Virginia. Effective immediately, all directors will renew their policy on an annual basis and the directors' status as a member of the

Commonwealth Mutual Fire Insurance Company

Home Office: Richmond, Virginia  
CAIS Administrative Office: 12115 Lackland Road, St. Louis, Missouri 63146

Company will be reviewed annually by the Company President at its board of directors meeting.

Accounts and Records

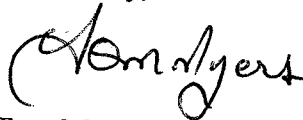
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The Examiners recommend the Company ensure that the custodial or safekeeping agreement have the controls outlined in the NAIC Examiners' Handbook. This is the second consecutive examination in which this recommendation appears.

Response

The Company has reviewed its custodial agreement and made appropriate changes to ensure controls outlined in the NAIC Examiners' Handbook are included in the revised safekeeping agreement. The revised agreement has been included as an attachment to this letter.

Yours truly,

A handwritten signature in cursive script, appearing to read "Tom Myers".

Tom Myers  
Commonwealth Mutual Fire Insurance Company  
Treasurer

Enclosure